

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

FILED

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PEGGY B. DEANS, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF N.C.

IN RE:

INTERNATIONAL HERITAGE, INC.
INTERNATIONAL HERITAGE, INCORPORATED

98-02675-5-ATS
98-02674-5-ATS

TRANSCRIPTS OF PROCEEDINGS

MAY 5, 1999; SEPTEMBER 22, 1999; DECEMBER 2, 1999

BEFORE THE HONORABLE A. THOMAS SMALL
UNITED STATES BANKRUPTCY JUDGE
RALEIGH, NC

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
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IN RE: *INTERNATIONAL HERITAGE, INC.*
98-02675-5-ATS (7)

INTERNATIONAL HERITAGE, INCORPORATED
98-02674-5-ATS

**TRANSCRIPT OF HEARING - MAY 5, 1999 - RALEIGH, NC
BEFORE THE HONORABLE A. THOMAS SMALL
UNITED STATES BANKRUPTCY JUDGE**

1. *MOTION FOR ORDER RELEASING RESERVE ACCOUNT AND
DETERMINATION OF THE APPLICABILITY OF THE
AUTOMATIC STAY*
2. *TRUSTEE'S APPLICATION TO ENTER INTO STIPULATION
AND CONSENT TO FINAL JUDGMENT*
3. *TRUSTEE'S MOTION FOR ORDER TO STAY PENDING
LITIGATION*
4. *MOTION FOR RELIEF FROM AUTOMATIC STAY*

APPEARANCES:

Trustee: *Holmes P. Harden*

Attorney for Trustee: *William Janvier*

Attorneys for Acstar Insurance: *Michael Flanagan and
Paul Fanning*

Attorney for L. C. Gilbert: *Ronald Garber*

Attorney for Stanley Van Etten: *Brent Wood*

Attorneys for Chittenden Bank: *Kathryn Koonce and
Jane Quasarano*

Attorney for U.S. Securities and Exchange Commission:
Susan Sherrill and Bill Hicks

Bankruptcy Administrator: *Marjorie K. Lynch*

Courtroom Deputy: *Christine A. Castelloe*

Transcribed by: *Jane W. Clapp*
1907 Wandering Way Drive
Charlotte, NC 28226
(704) 366-1057

1 (CALL TO ORDER)

2 (Transcription Note: All names and case citations will be
3 spelled phonetically unless verifiable spellings are
4 available.)

5 THE COURT: All right. Any other appearances?

6 MR. HICKS: Your Honor, Bill Hicks, H-i-c-k-s, also
7 on behalf of the Securities & Exchange Commission.

8 THE COURT: Ms. Koonce?

9 MS. KOONCE: Judge Small, I'd like to introduce to
10 the Court Jane Quasarano, who is here from Detroit, Michigan,
11 with the firm Jaffrey Wright Kure & Blythe, and she will be
12 arguing on behalf of Chittenden Bank today.

13 THE COURT: Okay.

14 MS. QUASARANO: Good morning, Your Honor. Thank
15 you.

16 THE COURT: Good morning. Okay, Mr. Harden?

17 MR. HARDEN: I just want to raise a couple of
18 preliminary matters. My motion for an order pertaining to
19 the Montana litigation and the State of Montana's responsive
20 Motion for Relief of Stay, we've agreed to continue both. I
21 think we're pretty close to a settlement of that. And Mr.
22 Callaway asked me to convey that he would request that his
23 motion be continued, and I would request that my motion be
24 continued to a later date.

25 THE COURT: Okay. All right, we'll continue the

1 Montana matters.

2 MR. HARDEN: Okay. And I also wanted to address the
3 motion that I had filed yesterday regarding a bifurcation of
4 the proceeding. We're prepared to go forward on all the
5 matters today, but I'm concerned, having received a
6 disconcerting letter from Acstar, that the Court make a
7 finding and I would request the Court to make a finding that
8 I have no duty to Acstar to-not to bring this before the
9 Court-and in fact that it's my responsibility and within
10 reasonable prudence as a trustee that it be brought before
11 the Court and it's been brought before the Court and that we
12 are properly before the Court.

13 I think we can address the jurisdictional issue if
14 you want to. I think we're here under 9019 and the
15 *Nationwide* case. We're not here to discuss Acstar's
16 responsibilities under the bond or their duties to pay under
17 the bond. All of that is between them and the SEC, and if
18 there's a question of avoidability, the SEC is willing to
19 take that risk in Georgia, but I want to make sure that the
20 Court-that this is the proper posture and that the Court
21 agrees that I'm the proper person to bring this before the
22 Court and that it's being brought properly before the Court
23 before we go forward.

24 THE COURT: You mean the motion to settle?

25 MR. HARDEN: The motion to settle, that's right.

1 The motion that we're about to hear, I presume.

2 THE COURT: Okay. Mr. Flanagan, you want to be
3 heard on that?

4 MR. FLANAGAN: Your Honor, I think Mr. Harden saying
5 he attached my letter to his motion, we probably need to
6 address that particular letter. He indicates that he
7 received a disconcerting correspondence from Acstar, and
8 there's been a series of correspondence between the parties
9 about this pending application, and we have requested that he
10 withdraw that application, and if the matter needs to go
11 forward in the state of Georgia, it can go forward in the
12 state of Georgia. It doesn't need permission from this Court
13 to go forward in the state of Georgia. If they reach a
14 settlement down there, then they can bring it back up here.

15 But I just didn't want there to be any confusion as
16 to what we thought ought to happen, so I wrote him a letter
17 and advised him that I wanted him to advise his carriers that
18 he was going forward despite the indemnity agreement that we
19 will be discussing, I feel sure, in more details later on.
20 That brought about this motion.

21 I would contend that as we stand procedurally, him
22 requesting that you enter an order that he had authority to
23 file the application simply is not before the Court properly
24 at this time, and I don't really know what good that would
25 do. You know, he can do whatever he wants to do as far as

1 filing an application, the way I look at it.

2 The jurisdictional issues really are at the heart of
3 the arguments for later on today when we discuss the
4 application. I've read the *Nationwide* case, which, of
5 course, you decided and it was upheld by the 4th Circuit. We
6 do not believe that case is controlling and are prepared to
7 argue that.

8 The other two matters he seeks in his motion to
9 bifurcate, (1) the effect of pursuing the application on the
10 viability of a bond, that certainly is for the Georgia court.
11 You know, we would contend, and I think quite forcefully, at
12 least in Georgia, that if this collusion and fraud--and I use
13 those terms in the legal sense, not in any bad connotation--
14 but if there's collusion and fraud between the SEC and Mr.
15 Harden on behalf of IHI, it may in fact terminate that bond.
16 But that is for a later day and a later court.

17 The third indication is he's wanting you to enter a
18 ruling that there's no personal liability of the trustee for
19 the actions that he is taking. Well, I don't know the end
20 result of the actions that he's trying to take, but we would
21 contend, as we will later on this morning, that if there's a
22 contractual obligation between IHI and Acstar, that IHI will
23 not increase the risk to Acstar under the bond if there's a
24 contractual obligation, if he agrees not to settle the case
25 without our permission. If he agrees to take certain other

1 acts that are prohibited, clearly prohibited, by the
2 indemnity agreement, which in essence is the application for
3 the bond, then there may be some personal liability as well
4 as liability of the estate. But again, we do not believe
5 that that is properly before this Court at this time on
6 simply his application to go forward.

7 With that being said, we are prepared to argue the
8 matters out in his motion or go ahead and have the entire
9 matter heard or do whatever the Court pleases, of course.

10 THE COURT: Okay. All right. Well, I tend to agree
11 with Mr. Flanagan. I'm not sure that the issue's mine to
12 decide. I mean you can either bring the application or not.
13 You've brought it. We're here. I'm prepared to rule on it.

14 Before we get to the specifics though, I mean let
15 me say I've read everybody's brief here and I'm pretty much
16 familiar with what the issues are, but I want to focus for a
17 minute on the big picture, and we've got a number of parties
18 that have adverse interests. They are in some situations
19 aligned and in other situations adverse to each other. We've
20 got the trustee; got the SEC; we've got Acstar; we've got Mr.
21 Van Etten, who I assume claims a lien on these bond proceeds,
22 has a claim against the estate, who is also a defendant with
23 respect to the SEC and the class action in the Montana
24 litigation and possibly a defendant with respect to the
25 trustee, although no adversary proceeding—I don't believe an

1 adversary proceeding's been brought. We've got Montana;
2 you've dealt with that. We've got Mr. Gilbert, who wants a
3 class action. I recently denied his motion for relief from
4 the stay. We've got the claimants. We've got different
5 classes of claimants. We've got the claimants that entered
6 into sales agreements with the debtors, and we've got other
7 creditors whose claims arise from other circumstances, like
8 Chittenden Bank, and we've got insurance companies other than
9 Acstar who may have some liability in this case. We've got
10 this lawsuit pending in Georgia; we've got an action in
11 Montana; we've got this class action in the Eastern District
12 of North Carolina.

13 And I guess my question is—and I know you've
14 probably worked on resolving all these matters—is there a
15 possibility of some comprehensive settlement in this case?
16 And my question is, is this a good case where mediation would
17 be helpful, and I just throw that out and I don't want to
18 know the specifics of any of your settlement talks. I just
19 raise this question because obviously if there can be a
20 settlement of all this, that's going to be in everybody's
21 best interest, but I don't want to waste everybody's time and
22 I certainly don't want to waste the Court's time by going
23 down that road if nobody thinks—or if somebody thinks—that
24 that's not a good idea. Mr. Harden, do you have any thoughts
25 on that?

1 MR. HARDEN: Well, Your Honor, in a sense I feel
2 like I'm serving as a mediator right now, and we are making a
3 lot of progress toward getting these issues resolved. Right
4 now the only party who seems to be totally opposed to
5 settlement is Acstar. I think that once we resolve their
6 issue, then, you know, Mr. Van Etten—we're about to make a
7 settlement proposal to Mr. Van Etten, and we can do that
8 within a couple of days practically. We've taken his
9 deposition. We know what his assets are, and we know how
10 strong our preference claims are and are ready to do a deal
11 with him.

12 The Montana litigation is, Mr. Wood, I think about
13 to be resolved. All we want you to do is approve a
14 settlement of this litigation so it can go back to Atlanta
15 and Judge Story can decide whether he wants to enter the
16 settlement or not. This takes three levels of approval. You
17 know, with the SEC approving it—they've done that—you need to
18 approve it. But it's not a done deal until Judge Story
19 enters the consent order, and Acstar's going to be able to go
20 down there and argue that entering the order would void the
21 bond. They can make their arguments to Judge Story. Judge
22 Story has jurisdiction over the bond. The Court really
23 doesn't have jurisdiction over the bond. I don't think
24 anybody argues that you do, except that there's a
25 reversionary interest which is property of the estate that

1 I'm trying to protect.

2 I'm not sure that—I think mediation would just add
3 another—at least in this point in time—it would be premature
4 and would add a layer of administration that we don't need
5 right now. That's my opinion.

6 THE COURT: Anybody else want to speak to that?

7 MR. FLANAGAN: Your Honor, we would mediate. The
8 problem we have, he indicates that Acstar is the only person
9 who is opposed to settlement in this matter, and less than a
10 year ago, my client was approached by a bond broker, Marsh &
11 McClellan, as to whether or not they would post this—I
12 suppose disgorgement bond is what I would call that, although
13 the SEC may have a better name and a more proper name for
14 that. My client underwrote and did their underwriting and
15 agreed for a fee to post the bond.

16 One of the major parts of the underwriting dealt
17 with whether or not Van Etten et al, IHI, was going to
18 vigorously defend the matter, and Mr. Wood, if called upon to
19 testify, I believe would indicate that he told the principal
20 parties of Acstar that there was going to be a vigorous
21 defense, that there were in fact viable defenses, and that if
22 the bond was ever called, either IHI or Mr. Van Etten,
23 through some insurance proceeds, would in fact make up the
24 difference, the million and a half, which is going to be,
25 when the next bond premium comes due on June 8, \$150,000 of

1 that \$3.5 million is going to disappear, according to the
2 agreement between the parties.

3 So I think it is unfair to say that we are the ones
4 opposing—

5 THE COURT: When you say the agreement between the
6 parties, what parties are you talking about?

7 MR. FLANAGAN: Well, IHI and Acstar.

8 THE COURT: Okay, there's no agreement with the SEC?

9 MR. FLANAGAN: Oh, no, no. No, no. No. But their
10 bond liability remains at \$5 million if the preconditions are
11 met, and I think that the SEC has indicated, at least in
12 writing, that we were trying to screw up that bond, and we
13 really aren't. We're saying the bond's there. If the pre-
14 conditions of the bond are met, my client is ready, willing,
15 and able to make the payment.

16 However, the concept of a consent judgment that then
17 takes \$1.5 million out of our pocket totally flies in the
18 face of our original agreement. It flies in the face of
19 surety-ship principles, and it just is unconscionable in our
20 opinion. But yes, we would mediate this matter if it was
21 deemed necessary.

22 Now, if all Mr. Harden wants to do, which I think he
23 certainly can do, is to resolve the amount of his claim with
24 the SEC, then I agree with him. You know, if he thinks that
25 they've presented sufficient evidence to say they've got a

1 six and a half million dollar claim, then that can be
2 resolved today and then everything goes down to Georgia. We
3 file our motion to intervene; we file our cross-claim against
4 Mr. Van Etten. You know, we're ready to go. We're prepared
5 to do that.

6 But the only thing that really should be in front of
7 you, we think, is the actual claim of the SEC, if in fact
8 this is the right forum for that, and I'm not totally sure
9 that you pre-approve a claim like this, and, you know, you
10 look at the proof of claim as two pages and attached to it
11 are the pleadings from Georgia. There's no place where you
12 find where it's six and a half million dollars.

13 But we'll be glad to mediate, but obviously if the
14 trustee does not think it beneficial—but you look at
15 procedurally, this case was filed on December—excuse me—
16 October 25, I think. The 341 meeting was December 30.
17 January—the SEC files a proof of claim on January 5, and lo
18 and behold, on January 15, this settlement document that
19 thick appears in court. I don't think we're being
20 unreasonable to try and examine each line of that and make
21 sure that everything's proper.

22 THE COURT: Mr. Wood?

23 MR. WOOD: Your Honor, certainly, as I think you've
24 pointed out, the interests of my client, Mr. Van Etten, are
25 not aligned with everyone else. We don't agree with

1 everything Mr. Flanagan says; we don't agree with everything
2 Mr. Harden said; and certainly we've disagreed respectively
3 with the SEC.

4 But the primary comment I wanted to make is that my
5 client is trying to make headway into resolving all of this.
6 This is a nightmare that has been following him around for
7 almost a year now, and I believe we've made some headway with
8 the SEC, and I believe we've made, as Mr. Harden said, great
9 headway with him and with the State of Montana, and we are—
10 I've tried to initiate some discussions with counsel for Mr.
11 Gilbert so all of this can get away, my point being is that I
12 might be of the opinion that a mediation would be of some
13 benefit to force all the parties at a position where they
14 would be trying to make some-what are going to be hard
15 decisions for everyone involved, including my client. So,
16 with that, I would think that a mediation might be of benefit
17 on behalf of my client.

18 THE COURT: Okay. Yes?

19 MR. HICKS: May I just be heard briefly? I do
20 agree—I'm Bill Hicks on behalf of the SEC. I do agree that
21 the issue of the enforceability of the bond is better before
22 the District Court, and I think that the trustee's
23 application is the way to get it there. On the
24 conscionability issue, I want to state what our view is just
25 so the Court knows.

1 We oppose—there originally was a cash bond posted in
2 the District Court case. The defendants moved to substitute
3 the surety bond which is at issue today. We opposed it for
4 various reasons, but after some back and forth, the Court
5 ultimately allowed them to do it. The bond on its face
6 states the conditions of the bond, in essence only that a
7 judgment be entered.

8 None of us knew about the indemnity agreement. I
9 don't believe the trustee knew about the indemnity agreement,
10 and I don't believe the District Court knew about the
11 indemnity agreement. It first made its appearance when the
12 trustee filed this application, and then it came in with the
13 objection. So the idea that anyone was involved in trying to
14 do an end runaround it or anything like that is totally
15 false.

16 So the question remains, is the bond enforceable on
17 the terms that are stated in the bond and which were
18 presented to the District Court, or does the indemnity
19 agreement somehow void that? It's a legitimate question. I
20 do think it's better for the District Court to address, but
21 that's what brings us to his point.

22 The mediation, I don't feel it would be productive
23 at this stage. I'm not sure—I'm sorry. Go ahead.

24 MR. HARDEN: And your judge has certain
25 jurisdictions I don't think the mediator could infringe upon.

1 MR. HICKS: That's true, too.

2 MR. HARDEN: You know, this is an administratively
3 insolvent estate at this point, Your Honor. What we're
4 trying to do here is a sensible deal to the benefit of the
5 creditors that will bring money into the estate, and I think
6 the quickest way to get the thing resolved is to go ahead and
7 start making some decisions, make some rulings, and then
8 things are going to fall into place—that's my personal
9 opinion—to the extent they haven't already. At least I would
10 ask the Court to give me more time to put some sort of a
11 comprehensive deal together.

12 But I agree with Mr. Hicks. I think that if we go
13 ahead and approve a settlement today and Judge Story listens
14 to Acstar's arguments, that's the way—that's the quickest way
15 to get some money into this estate. One way or the other, if
16 that bond—even if it turns out to be void, Your Honor, \$3.5
17 million will come back into this estate.

18 THE COURT: Do you agree with that?

19 MR. WOOD: Your Honor, there's clearly a promissory
20 note that—where my client loaned the money to the company.
21 My client has a security interest in that, so I think that my
22 client still has a right to enforce—try to enforce that
23 security interest. Mr. Harden may oppose it.

24 THE COURT: It's your position that the money—that
25 your client's entitled to that money and not the—

1 MR. WOOD: That's right.

2 MR. HARDEN: But that's a position we don't share,
3 and that would be an issue that could be resolved. That's
4 not the best result, but the best result is that we get
5 \$5 million free and clear of Mr. Van Etten's lien because he
6 doesn't have a lien on the bond. I mean if the bond gets
7 paid by the company to the SEC, then the SEC gifts it
8 essentially to the estate, there is no reversionary interest.

9 So we resolve Mr. Van Etten's claim on the
10 reversionary interest immediately, and that's one less thing
11 the Court has to consider. We don't have to file an
12 adversary regarding that. If we settle with Mr. Van Etten,
13 which I think we're about to do, you know, there won't be any
14 issues at all involving him.

15 But I'm concerned that there's—we have \$34,500 in
16 this estate, Your Honor, and we need to get some quick
17 decisions and generate some funds so we have an
18 administratively insolvent estate to prime this case and then
19 get some things done.

20 THE COURT: Okay. Approving your settlement doesn't
21 get you any money though until you go down to Georgia.

22 MR. HARDEN: But it's a step in the right direction.

23 THE COURT: Okay. Ms. Quasarano?

24 MS. QUASARANO: Your Honor, as you know, Chittenden
25 Bank also filed objections to the SEC settlement. We have

1 had discussions—in fact, just outside in the hallway—further
2 discussions, and probably will be able to resolve
3 Chittenden's objection to the settlement. I do need a chance
4 to call my client. So I don't believe it's in Chittenden's
5 best interest to go forward with the mediation either. I
6 think we can go forward, provided I get an opportunity to get
7 aproval.

8 And my other motion, of course, will still be up
9 today.

10 MR. HARDEN: Well, Ms. Humrickhouse represents the
11 estate with regard to avoidance actions and has taken Mr. Van
12 Etten's deposition and has something she'd like to add.

13 MS. HUMRICKHOUSE: I'd like to make a suggestion to
14 the Court with regard to your suggestion of mediation. I
15 think that it might be a good thing to do for the Court to
16 allow a short period of time of maybe 20 days to try to
17 resolve these issues and then to order mediation. I have had
18 some very good luck with mediation in proceedings that have
19 been in this court. I'm hopeful that a lot of the issues
20 might be able to be resolved outside of the mediation, and
21 then we can basically have a mediation that would deal with
22 Acstar if that's necessary.

23 I think that maybe the threat of mediation might
24 make some of the parties deal with it. Some of these things
25 are going to shake out. I think Montana will shake out by

1 itself. I think Chittenden will shake out by itself. I also
2 think that any deal or settlement with Mr. Van Etten, between
3 the trustee and Mr. Van Etten, will occur in that period of
4 time. But a lot of this is conditional upon funds coming
5 into the estate. This is an administratively insolvent
6 estate.

7 I have a concern on behalf of the trustee with going
8 forward. Your view of Mr. Flanagan's position with regard to
9 the bifurcation is something that's given me some concern
10 because I don't think that a trustee who, at least in good
11 faith, is trying to discharge his obligations with regard to
12 getting money into the estate should have to face liability
13 by virtue of filing an application, and that concerns me.

14 I think that we're all ready to go forward, Your
15 Honor. I mean we can argue the reasonableness of the
16 settlement. We can tell you the five-prong test by the
17 Supreme Court. We can go through all of that. And I think
18 that this Court would be persuaded that this settlement, if
19 funded through a ruling by Judge Story, would be in the best
20 interest of the estate.

21 But I'm concerned that without a ruling by this
22 Court, that the mere filing of this application isn't a
23 violation; it is putting Mr. Harden—like Mr. Crampton, Mr.
24 Holmes—Mr. Harden in a position that is untenable. I would
25 not want to be in that position myself, and I'm not sure that

1 trustees in this district need to be put in that position—or
2 in any district.

3 I think it's unfair for him to follow the rules or
4 think that he is doing so and have to face, you know, the
5 devil or the deep blue sea. If I don't go forward, I
6 probably am breaching my fiduciary responsibility to the
7 estate because here's a settlement that's on the plate that
8 is just a wonderful no brainer, as he's often called it, and
9 if I do go forward, I risk not only personal liability and my
10 trustee's bond being called upon and members of my firm
11 having liability, and I haven't talked to them about that,
12 but I'm sure the rest of Maupin Taylor & Ellis is a little
13 bit concerned about him going forward today, and I'm not sure
14 that it would be the Court's desire for him to face that
15 liability.

16 And I think that a very limited ruling might be
17 helpful and that the mere filing of an application seeking
18 the Court's authority to decide something should not put him
19 at that risk. That's the only thing I needed to say, Your
20 Honor.

21 THE COURT: All right. Mr. Harden, having heard the
22 other arguments about mediation, do you still feel like
23 mediation would be a waste of time?

24 MR. HARDEN: At this point, I think I need more time
25 to try to put something together. I mean at some point

1 mediation might be necessary, but I mean I'm not thinking
2 that we'd-

3 THE COURT: I'll tell you what, let me take a five-
4 minute recess and let you all think about this a little bit,
5 and then we'll decide whether we're going forward.

6 If we go forward with this hearing though, I think
7 the first issue we ought to focus on is the authority to
8 settle and whether or not, based on the terms of the
9 indemnity agreement that the debtor was a party to, you have
10 the authority to settle. Then if I make that decision, if
11 you do have the authority to settle, then we go forward and
12 hear whether or not the settlement's a good idea or not. Do
13 you all agree with that? Okay.

14 All right, recess for five minutes.

15 SHORT RECESS

16 (CALL BACK TO ORDER)

17 THE COURT: All right. Mr. Harden?

18 MR. HARDEN: Your Honor, we've agreed to a short
19 period to try mediation. We'd like to have twenty days
20 before you appoint a mediator, or you can appoint a mediator
21 but give us twenty days before the mediation and then call
22 this back before the Court. The same hearings go back on the
23 calendar in about thirty days, or sometime convenient after
24 thirty days, so we don't lose too much time.

25 THE COURT: Okay. All right. We can put this back,

1 Tuesday, June 8; Friday, June 11; Tuesday, June 15.

2 MR. HARDEN: What was the last day, Your Honor?

3 THE COURT: June 15.

4 MR. HARDEN: That would be good for me. I have 341
5 meetings in New Bern on the 11th.

6 MR. FLANAGAN: Is that a Friday or—

7 THE COURT: Tuesday.

8 MR. FLANAGAN: Tuesday would be preferred by my
9 client, Your Honor, so the 15th would be fine.

10 THE COURT: Okay. We'll put all these matters then
11 back on the calendar for June 15 at—could we do it at one
12 o'clock?

13 MR. JANVIER: Your Honor, the issue with regard to
14 Chittenden Bank or the chargeback accounts was not going to
15 be involved in the mediation, and we'd like to go ahead and
16 hear that once the mediation is set, and everybody else can
17 leave.

18 THE COURT: Okay. All right, so you want me to
19 appoint a mediator in twenty days?

20 MR. HARDEN: Or before twenty days, but we don't
21 want to begin mediation. We want to try to resolve it before
22 mediation, and we need about twenty days to do that.

23 MR. FLANAGAN: Your Honor, from what I've heard, I'd
24 like to go ahead and appoint a mediator and Ms. Humrickhouse
25 has proposed someone whom I have no objection to and—

1 THE COURT: Okay, who have you proposed?

2 MR. HARDEN: She's proposed Jackie Claire.

3 MS. HUMRICKHOUSE: Jackie Claire.

4 MR. HARDEN: And that's fine with me.

5 THE COURT: She's been successful before in this
6 court.

7 MR. FLANAGAN: Yes, and I think the concept is
8 there's some other matters that can get resolved and should
9 be resolved within twenty days so when we go to mediation, we
10 only have the principal players involved, and so the order
11 would envision not immediate mediation, but frankly twenty
12 days from now is almost as immediate as you can get.

13 THE COURT: Right. Right. Okay. Well, if no one
14 has any objection then, I will appoint Jackie Claire, and I
15 will call her to see if she's willing to serve. Is there
16 going to be any problem paying her in this case?

17 MR. HARDEN: I don't think there will be. The SEC
18 may have to get approval to participate. I understand
19 they'll need to chip in as well under the mediation rules,
20 but we have \$34,000 in the estate, and I think that would
21 cover it.

22 THE COURT: My experience in the past is her fees
23 have been very reasonable and she's been very successful. I
24 hope she can be successful in this case. All right. Okay,
25 well, I'll talk to Ms. Claire and appoint her, and if she is

1 unable to serve in that capacity, I will get back in touch
2 with you and see if you have-

3 MR. HARDEN: Okay. Mr. Flanagan has an alternate
4 that I think is satisfactory to us as well.

5 THE COURT: Okay, who would that be, Mr. Flanagan?

6 MR. FLANAGAN: Your Honor, I don't know that we
7 could get him, and his price is a little higher. I just
8 mentioned Harry Goodhart, who is from Tryon, North Carolina,
9 and Florida, and his resume is remarkable but-and I'd like
10 frankly for some of the folks in this area to meet him. He
11 would be right at the tops of what I've seen.

12 THE COURT: Okay. anybody have any objection to Mr.
13 Goodhart? All right. Well, I'll try Ms. Claire, and if she
14 can serve, I'll appoint her.

15 MR. FLANAGAN: If not, then if you could have
16 someone call me, I will call Mr. Goodhart and check into
17 availability and get his resume to the appropriate
18 individuals.

19 THE COURT: Okay. All right, well, that will take
20 care of all those matters except for Chittenden Bank.

21 MR. HARDEN: Your Honor, there was one thing I did
22 need to mention. In the concept of people resolving things
23 in this matter, there had been a small effort on behalf of us
24 and the SEC to reach a settlement prior to coming today, and
25 I don't think they thought we made a very meaningful offer

1 and there was no counter back, but I did want you to know
2 that contrary to what was said, we did in fact make a
3 settlement offer.

4 THE COURT: Okay. All right. Yes?

5 MS. QUASARANO: Ready to proceed, Your Honor? As I-
6 I'm sorry. As I mentioned earlier, Your Honor, I represent
7 Chittenden Bank. We filed a motion for releasing reserve
8 account, determination of the applicability of automatic stay
9 or for releasing the automatic stay.

10 We filed for three reasons, Your Honor, because
11 Chittenden is entitled to recoup, setoff, or security
12 interest. However, today's hearings made it a lot simpler by
13 some discussions that have taken place, including final
14 discussions in the hallway here and I'm going to put those
15 forward and, of course, if my misunderstanding is correct
16 (sic), Mr. Janvier can correct me.

17 But the trustee in the estate no longer disputes our
18 security interest but admits we have a valid perfected
19 security interest. The question is what chargebacks are we
20 entitled to set off or to take out of security interest.

21 As a little bit of background, I wanted you to know
22 that Chittenden Bank was the credit card processor for
23 International Heritage and anytime a company wishes to use
24 customers' Visa or MasterCard to purchase, they need a
25 credit card processor. Essentially, we provide

1 Visa/MasterCard to them, and they submit the credit card
2 slips to us, and subject to certain net-outs under the
3 contract we give them the money that they're entitled to
4 under the credit cards.

5 Under certain circumstances, customers can charge
6 back the credit cards. Perhaps you've been familiar with
7 that with other cases or personally, but there are certain
8 circumstances under which they can do that, and when that
9 happens, it's debited against my client's account because we
10 previously, you know, had submitted the card. Now, in order
11 to address that with various merchants, when we agree to
12 process credit cards for them, there's an agreement for a
13 reserve account, a security interest, specifically to prevent
14 my client from being responsible for disputes between the
15 consumer/customers and the merchant.

16 Now, in this case under our merchant agreement—and I
17 apologize—as Mr. Janvier noted, he found it difficult to read
18 the merchant agreement that was attached to our motion and
19 perhaps the Court did as well. May I have permission to
20 approach you with an enlarged copy?

21 THE COURT: Yes.

22 MS. QUASARANO: Thank you, Your Honor. Since the
23 issue of the security agreement's been resolved by
24 stipulation, the relevant paragraph is Paragraph 16, and I
25 think it's going to boil down to a phrase, a seven-sentence

1 phrase here, the entire dispute, as I understand it, with the
2 trustee.

3 The first sentence of Paragraph 16 says, "Merchant
4 will"—excuse me—"Merchant will pay the bank"—and then if you
5 skip over—"and bank shall have the right to debit merchant's
6 incoming transactions or any other funds of merchant in
7 bank's control"—which would address the reserve account.

8 Then if you go all the way down to (d)—I'm sorry—
9 (d), which is the last sentence of the first paragraph, it
10 says, "Where a cardholder"—and that cardholder would be the
11 customer, somebody who bought something from IHI—"contends or
12 disputes in writing the bank"—and then there's a series of
13 items that they can. Primarily those deal with they didn't
14 get what they paid for. That's 1, 2, 3, and 4. Chittenden
15 Bank's position is, because this says, "Where a cardholder
16 contends or disputes in writing," all we have to do to
17 establish a valid chargeback is get the complaint from the
18 customer in writing under the chargeback procedures.

19 It was specifically my client's intent that they
20 never have to be thrust into the middle of the legitimacy of
21 a cardholder dispute. Obviously, cardholders may dispute
22 items for merchants throughout the country that are not
23 valid. They may be unhappy over things that don't have legal
24 merit, or they may have merit, but it's Chittenden Bank's
25 position that we never get in the middle of that. If the

1 cardholder says that it is an improper charge, then we have
2 the right to debit the reserve account.

3 It's my understanding that the trustee's position is
4 that they have the right to analyze the legitimacy of the
5 charges and that they wish essentially many trials to go
6 forward as to whether or not the cardholder has properly
7 disputed these amounts. The trustee and IHI may have that
8 right to contend against chargeholders directly that they owe
9 money, but Chittenden Bank should not be inserted into the
10 middle of it, and I'd like to allow Mr. Janvier the
11 opportunity to respond.

12 THE COURT: Mr. Janvier?

13 MR. JANVIER: Your Honor, the first issue I'd like
14 to address is--well, there are several arguments in the motion
15 that was made. The first one is that they are entitled to
16 chargeback against this reserve account, and at the time of
17 the petition, there was about \$93,000 in the reserve account.

18 In the matter of recoupment and do not need relief
19 from the automatic stay, to the extent that's still an issue,
20 I would cite the Court the *Eastern Airlines* case. I'd like
21 to hand up a copy of that case.

22 MS. QUASARANO: Do you have one for me as well?

23 MR. JANVIER: I do.

24 MS. QUASARANO: Thank you.

25 MR. JANVIER: Your Honor, I'll just read a quote

1 from that case. I really handed it up so that the Court can
2 have it for its records. And that case says, "Courts have
3 repeatedly and consistently held that chargebacks from
4 deposit accounts are setoffs that must be approved by the
5 Courts." I'm not going to belabor that argument, but I do
6 think that relief from the automatic stay is necessary.

7 Your Honor, these chargeback accounts are certainly
8 property of the estate. They're held in the name of the
9 debtor. They're held by the merchant bank in this case,
10 Chittenden. As Ms. Quasarano said, Chittenden was a merchant
11 bank for International Heritage. There were a number of
12 other merchant banks out there as well who are in a similar
13 situation.

14 We do believe and have seen no reason why this
15 account is not subject to Chittenden's security interest.
16 The question is, is what is—what is secure? They're taking—
17 well, the posture of this hearing is that it is a motion for
18 relief from stay, and under Bankruptcy Code, Section 362,
19 Subsection (g), they, of course, have the burden of showing
20 that there is no equity in this account for the debtor. I
21 don't think they can meet that burden. I don't think they
22 have met it today. In order to meet that burden, they have
23 to show, I would contend, legitimate chargebacks of the type
24 described in their merchant agreement in amounts greater than
25 what is in the reserve account, an amount greater than

1 \$93,000. I don't think they can do that.

2 The first thing I would point out, pointing to the
3 same paragraph of this merchant agreement that counsel
4 pointed to, is this. It says under that little subsection
5 (d) at the end of the first paragraph in Section 16, "When a
6 cardholder contends or disputes in writing to bank or to
7 issuers that"--and then it lists a number of things that
8 chargeholders can dispute.

9 Well, Your Honor, I have asked, but not received,
10 and been told that they are not going to provide, at least at
11 this point, evidence that they have received disputes in
12 writing from cardholders. If they have gotten telephone
13 calls from cardholders saying, "Our goods were defective" or
14 "We didn't get our goods," that is not sufficient to allow
15 them to charge back under this agreement. I want to see the
16 writings.

17 This is not just the trustee or myself dreaming up
18 this potential problem that's out there. It's exactly the
19 issue that was addressed in the *Eastern Airlines* case I
20 handed up. In that case there was an excess of a \$1 million
21 chargeback account. There was a similar provision in the
22 merchant agreement, and the Court held that it was the bank's
23 responsibility to show written chargebacks that they had
24 received from credit card holders. The bank was unable to
25 come up with those written chargebacks, and the Court held

1 that the reserve account could not be set off or debited and
2 those assets came into the estate. So this is something that
3 we legitimately need to see.

4 Apparently the practice in the industry, apparently
5 people do call, but call in chargebacks all the time and
6 don't back them up with writing, so this is a concern of the
7 trustee. And until they do that, I think they fail to
8 demonstrate that there is no equity.

9 What I really would like to let the Court know
10 though—and my bigger concern besides just the documentation
11 concern—is what is going on here and how this is going to
12 affect the estate. As I said, Chittenden has refused to
13 provide the trustee with any of the chargebacks, or any
14 evidence of chargebacks, they've received from customers.
15 Other banks have. As I said, there are a number of banks in
16 a similar situation, and the chargebacks that I have
17 received—and they are voluminous—most of them are very, very
18 similar to each other. Ninety-something percent of them look
19 the same, and I'm going to hand up a sample of one that is
20 similar to the ones I've received from other banks. The only
21 way it's dissimilar is that this particular cardholder was
22 much clearer because they included a lot more information,
23 but the other ones are coming from the same gist, are coming
24 from the same angle.

25 The first interesting part of this agreement or of

1 this chargeback is the last page, and this is—the Court may
2 have seen these before and may not; I'm not sure—this is one
3 of the things that International Heritage was selling. These
4 are the retail business agreements. Essentially,
5 International Heritage and its salespeople, or customers,
6 whichever you want to call them, have this arrangement.
7 These salespeople would pay International Heritage a sum of
8 money, in this case \$750, to become a retail business agent
9 or salesperson. This gave them the right to market
10 International Heritage products.

11 Now, under this agreement, this is what they could
12 do. They initially paid in \$750, often by credit card, and
13 then they would start buying and selling IHI product. When
14 they sold a sufficient amount of product, they earned back or
15 they had the right to get back the \$750 in the form of future
16 product. Now, what this individual charge person is doing on
17 his chargeback is trying to get that \$750 back. Before he
18 could sell sufficient stuff to get his \$750 back in the form
19 of future product, IHI went out of business.

20 Now, instead of filing a claim in the bankruptcy
21 case, he decided that he was going to get his money back from
22 the credit card company, and he did this because he was
23 directed to do so—and this was actually prepetition—by the
24 Attorney General's office. If you look at the fourth page of
25 this chargeback, there's a memorandum from the North Carolina

1 Attorney General's Office, Consumer Protection Section,
2 telling or directing IHI former salespeople that one of their
3 options was to charge back against their credit card and that
4 way they could get their money out. And as counsel has told
5 you, people are continuing to do these chargebacks post-
6 petition.

7 Now, here is my concern and here is the trustee's
8 real concern here. These individuals are using this
9 chargeback mechanism to get paid without going through the
10 bankruptcy claims process, and this is how it affects the
11 estate. They charge back against banks like Chittenden.
12 Chittenden says, "Okay, I've got a chargeback and debits
13 against this chargeback account, which is property of the
14 estate." So through this whole mechanism, these folks send
15 in their chargebacks, they get paid by the bank, the bank
16 gets paid by us, and neither the trustee nor the Court ever
17 has the ability to go in and dispute these chargebacks in any
18 meaningful manner.

19 Now, I hold no opinion and the trustee has not
20 expressed an opinion to me as to whether or not chargebacks
21 like the one I handed up are legitimate, and it's expressed
22 no opinion as to this individual who did this one, Mr.
23 Caldwell, or Ms. Caldwell, having legitimate claim in the
24 bankruptcy. I don't hold an opinion on that. The opinion I
25 do hold is that the Bankruptcy Court is the place it needs to

1 decide that. I don't think they should be able to get paid
2 and have estate assets in the form of a chargeback account be
3 depleted without it coming through this Court, and that is
4 why we're here objecting.

5 Now, this agreement does say that where a cardholder
6 contends or disputes in writing to a bank, that they have the
7 right to chargeback. I don't think you can read that to mean
8 any contention or any dispute. I think there has to be some
9 legitimacy to that. They can't take a complete sham
10 chargeback, which some of these may be determined to be--they
11 can't take one of those and use it and therefore take money
12 out of the reserve account that's property of the estate. I
13 think there has to first be (1) they have to show that it was
14 made in writing so it complies with the agreement; (2) they
15 have to show that there is some legitimacy to it, and the
16 best way to do that is to have those claims, those chargeback
17 claims, determined right along with the claims which are
18 going to be filed in this Bankruptcy Court because my guess
19 is the same people who are filing chargebacks are filing
20 proof of claims and under the exact same reasoning.

21 So, that is why we're here objecting to them taking
22 the chargebacks. No. 1, we haven't seen the chargebacks and
23 we don't know if there's even writing to back them up. But,
24 No. 2, we haven't been given access to determine whether
25 these chargebacks have any legitimacy, and we need the

1 account to stay in place until we can do that.

2 As a matter of adequate protection, the bank really
3 can't get more protected that it is now. The account's
4 sitting in their bank. So there is no danger in just leaving
5 the account where it is. We may in fact come forward with a
6 motion for turnover, and if we made a turnover demand of that
7 account, that's a different issue. But we certainly think
8 that just to let them have the account based upon the
9 evidence before the Court now without the trustee having an
10 opportunity to see and contest it would not be correct.
11 Thank you.

12 MS. QUASARANO: May I respond to those?

13 THE COURT: Yes.

14 MS. QUASARANO: My arguments fall down in four main
15 categories, and they're brief, but one, recoupment was not an
16 issue because they had conceded our security interest.
17 However, if this Court—I believe that recoupment would be
18 entirely appropriate because everything arises out of
19 chargeback processing. It's clearly one transaction, and
20 although it's not directly before you, I would ask that you
21 order or enter a ruling that recoupment is appropriate in
22 credit card processing. However, for the record, we have not
23 recouped. When we learned of the petition, we did freeze the
24 account, and because we didn't want to take these actions
25 that may in violation of the bankruptcy code.

1 Two, as to the positions in *Eastern*, first of all,
2 Mr. Janvier didn't cite that in the response and I didn't
3 scour through that case in preparation for today's hearing,
4 but I have read it in the past because I represent credit
5 card processors and I'd just like to note that to my
6 understanding, there's no similar document with the language
7 of a cardholder contending in writing in *Eastern* that I
8 recall, and in that case, the merchant processor, I believe,
9 virtually admitted that they had no backup or documentation
10 for chargebacks, and that's simply not the case here today.
11 Chittenden does have backup. I have no knowledge of any
12 telephone chargebacks.

13 It is true that I did not voluntarily turn over
14 certain information relating to the chargebacks to Mr.
15 Janvier, based on discussions that we had about this motion
16 where I understood his only question was the legitimacy of
17 the chargebacks. Both Mr. Janvier and Mr. Holmes (sic) had
18 told me, "Well, maybe these customers are right. Maybe
19 they're filing sham chargebacks." And my client's position
20 is it's irrelevant if the chargeback itself is valid or not.
21 Under the contract, as long as they submit a chargeback to us
22 disputing their transaction with the debtor, we have the
23 right to take those monies out of the reserve account.

24 Looking at the documents provided by Mr. Janvier,
25 these don't look like sham chargebacks. These are the types

1 of things that people have gone through and prepared in
2 accordance with the credit card processing rules through
3 their issuing bank where they've put a valid dispute in
4 writing. And I have an affidavit from my client that says
5 that they have received over \$129,000 worth of chargebacks
6 that they have had to pay that conform—that are within the
7 scope of Paragraph 16 of our agreement.

8 If the Court would like to rule that we actually
9 have to give paper copies of the chargebacks to prove that
10 the consumer contended the dispute, I would be happy to
11 comply with that; but I did not want to feed the argument
12 that we have to prove the legitimacy. Chittenden Bank
13 nowhere stepped into the role of arbitrating disputes between
14 the customer and IHI. The fact that IHI granted a
15 prepetition security interest in this reserve account gives
16 us these rights. They signed an agreement with the terms,
17 and the terms weren't that you have to prove that each
18 dispute with a cardholder is legitimate.

19 So, even though this account may be property of the
20 estate, it's subject to our security interest, as Mr. Janvier
21 just said, and our security interest allows us to charge the
22 account when a customer disputes in writing to us.

23 Mr. Janvier would like to stop this process where
24 consumers get credit on their charge cards for charges that
25 they believe are invalid or fraudulent. If the trustee had

1 really wanted that process to be stopped, there is a
2 mechanism within the Bankruptcy Code, Section 105, Relief for
3 Extension of the Scope of the Automatic Stay. It could have
4 been an option. I don't know whether this Court would or
5 would have not granted such a request. I certainly believe
6 that customers who purchase items on charge cards have rights
7 under those charge cards, even though a bankruptcy petition
8 is filed, but the trustee didn't do that.

9 So this process has gone on, and my client has been
10 personally charged--as personally as a corporation can be
11 charged--with 129,000, or I think my attribute is
12 approximately 120--the number rose every day--\$120,000 in
13 charges that are directly attributable to IHI. We advanced
14 those funds, and now they have been taken back from us.

15 Because there is no equity in this account, we have
16 already processed chargebacks that exceed the amount, and
17 because there's no reorganization, there's simply no reason
18 today that we shouldn't be granted relief from the automatic
19 stay.

20 And again, I do have an affidavit, and if this Court
21 rules that that doesn't satisfy the burden of proof, I'd be
22 happy to produce copies of the written chargebacks in that
23 amount as long as the Court's ruling is clear that all I have
24 to do is demonstrate that the cardholders contended there was
25 a dispute, not that their dispute is a legitimate one.

1 Thank you, Your Honor.

2 THE COURT: Okay. Mr. Janvier?

3 MR. JANVIER: Your Honor, again, the effect of that
4 ruling would be—let me start this way. With respect to
5 Chittenden, they stopped processing IHI credit cards in—I
6 think it was June of '98—so even four months prepetition,
7 there were no new monies being paid to IHI, no new charges
8 coming through. The chargebacks that happened after post-
9 petition were at least four or five months old, and most of
10 them much earlier than that, I suspect, although again I
11 haven't seen the documents.

12 So these claimants are able to come in postpetition
13 and take money of the debtors without this Court or the
14 trustee being able to do anything about it. Now, if
15 Chittenden has been paying these customers back, I think that
16 may have been a mistake. I think maybe they should have come
17 into court and had some resolution of this. I don't think
18 they can pay the customers back and then come in and say,
19 "Oh, we are safe because we've got \$93,000 in estate money
20 that we're allowed to charge back on." I think they do have
21 some burden of making sure the chargebacks are legitimate.

22 And as for the chargeback I handed up, I'm sure this
23 person did pay \$750 for a retail sales agreement, retail
24 business agreement. My question is, is he entitled to that
25 money back or not, and that's something I think the

1 Bankruptcy Court will have to decide, and until it does, I
2 don't think Chittenden is allowed to take this money, and I
3 think it would be a very clear question if the credit card
4 holders individually were coming and taking estate money.
5 That would clearly be a violation of the automatic stay, but
6 that's in effect what's happening. It's just one step
7 removed. They're taking from Chittenden, and Chittenden is
8 taking it from us. I don't think that makes a difference. I
9 think the result is the same, that estate assets get depleted
10 without this Court or the trustee having a say in it.

11 So, I would ask that the chargeback account stay
12 where it is and that Chittenden have to prove or that
13 Chittenden bring before the Court the issue of whether or not
14 these chargebacks are legitimate, because like I said, my
15 guess is-my hypothesis is-they're all very much the same,
16 that they all look much like the one I handed up unless they
17 are different from the other banks that are out there. This
18 one is from Centura; it's not from Chittenden.

19 THE COURT: Okay. Well, Chittenden finds itself at
20 this point in a situation of not taking money from the estate
21 but they're in the paying out business at this point. These
22 claims are going to keep coming in, and I mean it may be it
23 has that effect on the estate, but Chittenden does have a
24 security interest and-

25 MR. JANVIER: Your Honor, they do to the extent that

1 they got--and the one chargeback's in writing, which we don't
2 have evidence of--

3 THE COURT: Right, but they'll supply you with that.

4 MR. JANVIER: --and they'll supply that. But I also
5 think that there is a--that these chargebacks must have some
6 legitimacy.

7 THE COURT: It doesn't say that in the agreement
8 though.

9 MR. JANVIER: Well, Your Honor--

10 THE COURT: I mean you say it's an unwritten--

11 MR. JANVIER: It doesn't say, "Even if"--you know,
12 it doesn't say after that, "Even if these things are
13 completely fanciful." I think you read a duty of good faith
14 and fair dealing into every contract. I think you read
15 reasonableness into every contract, particularly--and I think
16 you construe the contract's against them since they drafted
17 it--but I don't think this gives them a blank check to take
18 estate assets anytime somebody writes them a letter saying,
19 "I want my money back."

20 THE COURT: All right.

21 MS. QUASARANO: Very briefly, Your Honor, is that my
22 client isn't just voluntarily paying off, you know,
23 individual checks to people. The credit card processing
24 system is a net out system among various banks, and we are
25 being charged these to the credit card processing net out

1 system. I mean I don't have a choice. And as you've noted,
2 we are continuing to pay out on customers who file valid
3 chargebacks. We have to continue to pay for IHI's debts.

4 The agreement was specifically drafted to protect us
5 in this type of a situation and not to require us to inquire
6 into, you know, the legitimacy of the dispute between the
7 customer and a merchant. And even in good faith, we're more
8 than performing as we continue to address chargebacks from
9 IHI.

10 And the trustee does have a remedy. If the trustee
11 feels that a particular chargeback was improperly granted and
12 that a customer has absolutely no basis for this, they may
13 file a claim. They may file a claim. They can file a
14 lawsuit against them saying, "Now, your action, which was
15 void and fraudulent and everything else, resulted in a
16 depletion of the security account that could have been
17 property of the estate if the chargebacks hadn't exceeded the
18 amount." And there's a procedure for the trustee to do so,
19 so they're not without a remedy here.

20 THE COURT: What's the bank's remedy at this point,
21 say if I did allow you to take the \$93,000; where are you
22 then? I mean do you just continue to have these losses?

23 MS. QUASARANO: Yes, we will continue to have the
24 losses; however, we will be permitted to apply this money
25 that was in our--you know, in the bank's accounts to our

1 losses. As of this time, you know, we have incurred—we have
2 not accessed that reserve account.

3 THE COURT: Right, but the bank has no defense at
4 all to these? All you need—

5 MS. QUASARANO: No. The defense is that we initiate
6 through the credit card processing rules, which we are doing
7 vigorously because every charge credit that comes in, we may
8 have to pay out more money. However, we have already been
9 charged back. I mean Visa has said, "These are valid
10 chargebacks. They are coming out of your account,
11 Chittenden," period—for one hundred and twenty-some thousand.
12 We have another \$22,000 still pending.

13 THE COURT: Right, but if one comes in today, as it
14 probably will, what's your defense? I mean is there any
15 defense to it?

16 MS. QUASARANO: No, there are only very limited
17 defenses under the credit card rules, so we look at a
18 chargeback for those purposes, but we could very well
19 continue to be held liable for ongoing chargebacks.

20 THE COURT: Have you asserted any defenses with
21 respect to these?

22 MS. QUASARANO: Yes, we have, Your Honor. We have.

23 THE COURT: What are those defenses generally?

24 MS. QUASARANO: Oh, it can be that someone hasn't
25 attached the required—for example, if a consumer makes a

1 claim that the debtor promised it a refund in writing and the
2 debtor never gave the refund, never processed it on their
3 credit card, under the Visa rules, then you have to attach a
4 copy of the promise from the debtor.

5 THE COURT: Okay, but those are all technical
6 things?

7 MS. QUASARANO: Right. It's only technical defenses
8 that we're entitled to make.

9 THE COURT: So if you get all the paperwork, then
10 you've got to pay it out, even though it's a bogus claim?

11 MS. QUASARANO: Right. We don't get that
12 opportunity. So we've been defending vigorously, but many of
13 these will be valid under the Visa/MasterCard system. And
14 when I had talked to Mr. Janvier earlier, I said, "Visa's
15 ruled on these." And, you know, his opinion was that Visa's
16 ruling can't affect property of the estate.

17 MR. JANVIER: Your Honor, and that's part of my
18 problem with this, is that Visa is ruling on things that
19 affect estate monies instead of this Court, and I don't trust
20 Visa to rule quickly on it.

21 THE COURT: Well, does Visa get into the legitimacy
22 of the claim?

23 MS. QUASARANO: Not to my knowledge. It's more of a
24 proof system because remember—and I could—Your Honor, if you
25 have a specific question about this, I would prefer to answer

1 it with a brief when I have an expert who can give you—but
2 I'm going to tell you—

3 THE COURT: Right. Well, I'm just thinking, I mean
4 if I bought a refrigerator and paid for it with my Visa card
5 and everything was fine and I just sent in a claim that I
6 wanted my money back—

7 MS. QUASARANO: Perhaps it might get honored under
8 the Visa system, but the store would still have recourse
9 because they could go back against you. Remember,
10 Visa/Mastercard is simply a payment system—okay?—and it's not
11 designed to be the ultimate arbiter of every dispute between
12 consumers and merchants. It's a method of electronic
13 transfer of funds that facilitates commerce. The banks that
14 participate in this system facilitate that, and there are
15 rights under the system for cardholders. But, you know,
16 those rights aren't perfect. The system isn't perfect.

17 If you had a series of specific questions about how
18 Visa ultimately decides these disputes, I could—I'd have to
19 go get an expert—but I know from this case and other cases
20 that the merchant bank, the processing bank, sends them back
21 with whatever dispute that they have, primarily technical
22 effect. I've only seen technical. And then Visa decides if
23 it's going to be valid or not, and then if the customer
24 itself—if IHI has a problem—they can sue the consumer and not
25 use Visa as an intermediary. Visa was never intended to

1 intermediate between all consumer disputes.

2 MR. JANVIER: Your Honor, that's sort of an illusory
3 remedy. I mean I don't think that this Court really wants
4 the trustee to go filing twenty, thirty, fifty thousand
5 lawsuits against consumers around the nation who did
6 allegedly illusory chargebacks. It makes much more sense as
7 a practical matter to let--well, to have the banks here and do
8 it very simply with a few banks rather than with, you know,
9 however many tens of thousands of chargeback customers--
10 chargeback individuals--around the nation. I mean it's just
11 not practical for the estate to go after all those
12 individuals.

13 And, yes, the Visa/Mastercard is a payment system,
14 but I don't think it's such an illusory payment system that
15 the debtor can get paid by a credit card and, you know, not
16 know if they're really paid, and somebody can come and charge
17 it back a year later and get money out of their reserve
18 account. I just don't understand credit cards to work that
19 way. There needs to be some finality, and we're not--you
20 know, neither the trustee nor International Heritage was a
21 part of this Visa system except that they were, you know,
22 allowed to accept charge cards. You know, we're not privy to
23 whatever hearing, but I assume there are no hearings. I
24 assume there's just paperwork that's going to the Visa system
25 to determine whether it's legitimate or not.

1 THE COURT: Well, on the other hand, I mean
2 International Heritage did sign this agreement, and they
3 wouldn't have had a MasterCard or a Visa processor unless
4 they agreed to these terms so—

5 MS. QUASARANO: I don't want to take up too much of
6 the Court's time, but my client needs a less illusory, you
7 know, more substantial and with deeper pockets than one
8 person, but that doesn't mean that under the terms of the
9 agreement it's our obligation to prove the legitimacy of the
10 chargeback.

11 THE COURT: Okay. Well, let me think about this a
12 little bit and I'll let you know my decision. At a minimum,
13 I would require at least the paper writings and the names of
14 all the chargebacks so that the trustee could at least match
15 those up with the claims that have come in.

16 Anyway, I think there are good arguments on both
17 sides of this. Do you have any other cases, any cases you
18 want me to look at?

19 MS. QUASARANO: Well, I had cited in my brief—
20 perhaps I could request the opportunity to just submit a
21 supplemental brief on *Eastern* if necessary, just a paragraph,
22 since—

23 THE COURT: Well, just a paragraph.

24 MS. QUASARANO: Okay. We'll—okay.

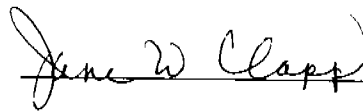
25 THE COURT: Not more than that.

1 MS. QUASARANO: Okay.
2 THE COURT: Okay, we can adjourn for the day.
3 MS. QUASARANO: Thank you, Your Honor.
4 (HEARING CONCLUDED)
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In Re: International Heritage, Inc.
International Heritage, Incorporated
98-02675-5-ATS
98-02674-5-ATS

C E R T I F I C A T E

I, Jane W. Clapp, having been tested and approved by the Administrative Office of the Court in Washington, D.C., to provide transcription of legal proceedings from electronic sound recordings, do hereby certify that the foregoing is a true and accurate transcript, to the best of my ability, of the above entitled matter.



Jane W. Clapp

2-14-00

Date